...ion of
...ve
...
...on

THE INTERIM

MAY 1998 HELENA, MONTANA VOL. XI NO. 12

LEGISLATIVE AUDIT COMMITTEE

Audit Committee Meets in March...The Legislative Audit Committee met March 27 in Room 104 in the Capitol. The following reports were presented.

FINANCIAL-COMPLIANCE AUDITS:

Board of Investments (97-3)

This is the annual report for the Montana Board of Investments for fiscal year 1996-97. Included in the report are eight sets of financial statements and the Independent Auditor's Report on each of the sets of financial statements. An unqualified opinion was issued on all of the statements, which means the reader may rely upon the fairness of the amounts presented.

Department of Administration (97-14)

This report contains the results of the financial-compliance audit of the Department of Administration for the two fiscal years ending June 30, 1997. The previous audit report contained one recommendation to the Department. The Department implemented the recommendation.

This report contains 33 recommendations directed to the Department. Ten recommendations relate to the monitoring and management of the Group Benefits Program. Six recommendations relate to the calculation of fees commensurate with costs for the Internal Service Funds. Other recommendations in the report include issues on state and federal compliance and proper recording of financial activity on the state's accounting records.

A qualified opinion was issued on the financial schedules presented in this report. This means the reader should use caution when relying on the presented financial information and the supporting detailed information on the statewide budgeting and accounting system.

The Department concurred with the recommendations in this report.

Single Audit Report (97-2)

The Montana Single Audit Report for the two fiscal years ending June 30, 1997, contains four sections: (1) FY 1995-96 Financial section; (2) FY 1996-97 Financial section; (3) Federal Single Audit Reports section; and (4) Audit Issues section.

The Audit Issues section contains all federal issues, recommendations, and responses by state agencies identified since the issuance of the last single audit report. All issues included in this section can be found in the individual audit reports issued for those agencies. The Federal Single Audit Reports section includes reports required under the federal Single Audit Act of 1984. The FY 1994-95 and FY 1996-97 Financial sections contain the General Purpose Financial Statements, which are included in the state's Comprehensive Annual Financial Reports for those years. The Comprehensive Annual Financial Reports are made available to legislators by the Department of Administration. These sections also include the FY 1995-96 and FY 96-97 Schedules of Federal Financial Assistance for the state of Montana. These schedules are prepared by the Office of Budget & Program Planning and document, by federal program, the over $1 billion in federal assistance received by the state in FY 1995-96 and again in FY 96-97.

Department of Public Health and Human Services (97-13)

A financial-compliance audit of the Department of Public Health & Human Services (PHHS) was performed for the two fiscal years ending June 30, 1997. PHHS was created as a result of reorganization approved by the 1995 Legislature. Chapter 546, Laws of 1995, reorganized the state's health and human services agencies effective July 1, 1995. The bill consolidated all or portions of the Departments of Social and Rehabilitation Services, Family Services, Health and Environmental Sciences, and Corrections and Human Services into one agency.

The status of prior audit recommendations related to functions currently at PHHS was determined. Of the 52 applicable recommendations, PHHS implemented 29, partially implemented 8, and did not implement 15.

An adverse opinion was issued on the financial schedules for each of the two years under audit. The opinion discusses misstatements exceeding $85 million. Approximately $64.4 million of misstatements resulted from misclassifications. The largest single misstatement is $58.8 million that relates to a misclassification of food stamp expenditures in fiscal year 1995-96. Other misclassifications, totaling approximately $5.6 million, relate to grants expenditures and impact both fiscal years 1995-96 and 1996-97. The reader should not rely on the presented financial information and the supporting data on the Statewide Budgeting and Accounting System.

This audit report contains 24 recommendations to PHHS. The first recommendation, with additional support from issues discussed in recommendations 2 through 10, addresses the need for PHHS to implement an improved management control structure. This report discusses over 25 different accounting errors ranging in amounts from approximately $380 to $19.4 million. The various reasons given in explanation of the errors indicates an immediate need for management to improve its control structure.

In general, a control structure is a process designed to provide management with reasonable assurance it will achieve its objectives related to financial accountability and compliance with laws and regulations. There are five categories of control structure components:

1. Control environment sets the tone of an organization. It includes management's commitment to integrity and competency, placing the right people in the right jobs. Assignment of authority and responsibility provides assurance that all personnel understand the organization's objectives, and how they contribute to those objectives.

2. Risk assessment provides a basis for identifying risks to achieving objectives and determining how to manage them. Risk factors include changes in the operating environment, systems, personnel or personal situations, and organizational restructurings.

3. Control activities are those policies and procedures that ensure management directives are carried out. Control activities pertain to information processing and include physical controls to safeguard assets, as well as segregation of duties that reduces the opportunities for an individual to perpetuate and conceal errors or fraud.

4. Information and communication relate to the methods and records used to record, process, summarize and report an organization's transactions. The quality of the information directly impacts management's ability to make appropriate decisions. Communication provides an understanding of individual roles and responsibilities and how they relate to the work of others. Communication includes policy and accounting manuals, memoranda, oral discussion, and management actions.

5. Monitoring is assessing the quality of a control structure over time. It requires timely response to changing factors affecting design and operation of controls. Regular management and supervisory activities can provide an on-going monitoring process. An internal audit function in an organization provides a separate evaluation of the design and operation of controls. External sources, e.g. clients, also provide feedback on an organization's control structure.

Recommendation #2 specifically addresses management's interpretation of state law and policy with respect to expenditure accruals. Recommendations #3 through #8 address various accountability and management issues related to the foster care program. Similar foster care issues and recommendations have been reported since 1989.

Recommendation #9 is a repeat finding addressing unreconciled accounts payable associated with the Child Support Enforcement Division. As of June 30, 1997, the net accounts payable totaled ($36,269) with some accounts having been on the accounting records since June 30, 1994.

Recommendation #10, also a repeat finding, discusses the process PHHS uses to report its expenditures of federal financial assistance program expenditures to the Governor's Office of Budget and Program Planning. The audit identified 19 instances where incorrect expenditures were reported; the misstatements ranged from $5,978 to $3,604,900.

Federal compliance findings impacting most of the PHHS federal programs are discussed in recommendations #11 through #17. Issues include PHHS requests for over $91 million from the federal government in excess of PHHS's immediate cash needs. There are specific recommendations relating to Medicaid; AFDC; Food Stamps; Food Commodities; Women, Infants and Children; and Temporary Assistance to Needy Families. PHHS systems for subrecipient monitoring and reviewing for debarred and suspended parties are also addressed.

The remaining recommendations (#18 through #24) relate to compliance with state laws and include misspending restricted appropriations, theft reporting, Medicaid information required to be included in budget requests, payroll controls, alcohol tax proceeds distributions to local governments, statutory appropriations, and an invalid fund transfer.

State Fund (97-5)

A financial-compliance audit of the State Compensation Insurance Fund was completed for the fiscal year ending June 30, 1997. An unqualified independent auditor's report on the State Fund's financial statements was included in the State Fund's annual report and a separate report was not published by the Audit Committee.

Department of Commerce (97-15)

This financial-compliance audit report contains the results of an audit for the two fiscal years ending June 30, 1997. An unqualified opinion was issued on the financial schedules contained in this report. This means the reader can rely on the presented financial information and supporting information on the Statewide Budgeting and Accounting System.

The report contains five recommendations where the Department could improve compliance with state law and policy. Recommendation #1 relates to establishing fees commensurate with costs at the Professional and Occupational Licensing Boards. The second recommendation discloses noncompliance with the Employee Ownership Opportunity Act. The third recommendation discusses the issuance of bank examination reports and consumer loan audits. The fourth recommendation addresses compliance with board meeting requirements and providing education and research as required by law. The last recommendation relates to the accounting for horse racing exotic wagering.

Montana State University - All Campuses (97-10)

This financial-compliance audit report contains the results of the audit of the Montana State University campuses for the two fiscal years ending June 30, 1997. The report contains 13 recommendations where Montana State University could enhance compliance with federal regulations and state law and policies.

Unqualified opinions were issued on the financial statements for Montana State University-Bozeman, Montana State University-Billings, and Montana State University-Northern for fiscal years 1995-96 and 1996-97. This means the reader may rely on the presented financial information.

PERFORMANCE AUDIT:

Construction Contract Administration, Department of Transportation (97P-05)

A performance audit was completed of the Construction Contract Administration (CCA) process which is administered by the Montana Department of Transportation. This process is designed to monitor and oversee all aspects of highway construction contracts. Audit work focused on examining the process after the construction contracts have been awarded. Areas of review included contract monitoring, project inspections, review and approval of contractor payments, and the reporting structure between district and central office personnel. Overall the audit found the process is working as intended and does provide a quality control function over the construction of state and federal highways. Report recommendations suggested improvements in the following areas:

1. Evaluate CCA managers' performance.
2. Evaluate the need for the formal partnering process.
3. Either eliminate or fully implement the change order policy.
4. Examine the level of monitoring needed for lower risk projects.
5. Examine and change the role and authority of the Construction Bureau and the districts in the CCA process.

ELECTRONIC DATA PROCESSING (EDP) AUDITS:

Teachers' Retirement System (98DP-03)

This EDP audit provides information regarding the Teachers' Retirement System computer-based application. Overall, the audit concluded general and application controls provide for controlled application processing. There were five recommendations for improvement, including restricting electronic access to critical files and programs, more thoroughly documenting a disaster recovery plan, and improving documentation of critical application processes.

MOTRS, Department of Transportation (98DP-04)

This EDP audit of the Montana Online Tax and Reporting System (MOTRS) at the Department of Transportation reviewed development controls in relation to contract criteria and industry standards. The audit includes recommendations for improving controls to ensure development results meet user expectations.

To Meet in June...The next meeting of the Legislative Audit Committee is tentatively scheduled for June 23.

INTERIM PROPERTY TAX COMMITTEE

Committee Meets in the Northeast...The Interim Property Tax Committee (IPTC) met April 16 in Wolf Point and April 17 in Glasgow to continue its examination of Montana's property tax system. The IPTC members clarified specific problems identified so far and developed a list of findings to guide future deliberations.

The main topic of the work session was a proposal by Rep. Emily Swanson for an acquisition value appraisal system for owner-occupied homesteads only, modeled on the system employed in Florida. Rep. Alvin Ellis, Jr., also presented an outline for an acquisition value system for all property classified as Class 4 -- basically, homes and businesses. Preliminary fiscal analysis of Rep. Swanson's proposal indicates potentially significant revenue decreases, barring, of course, rate or levy increases on other types of non-homestead property.

Committee Discusses Utility Taxation...The taxation of utility property continued to be high on the list of topics of interest to the Committee and others. Members were informed that the Revenue Oversight Committee (ROC) continues to grapple with utility taxation, in fact taking the bulk of the April 3 ROC meeting to examine the matter. Dennis Burr, Executive Director of the Montana Taxpayers' Association, had briefed the ROC on a MonTax option that, if enacted, would supplant the current property taxes on utilities with a generation (excise) tax. Because the IPTC and ROC share four members in common, a fairly good discussion was engaged by the IPTC. Jeff Martin, Legislative services Division Research Analyst and lead staffer to the ROC, will present a more complete update on utility taxation at the IPTC meeting in Whitefish, scheduled for Thursday, May 14 in the North Valley Medical Center Community Room.

Sales Tax Resurfaces...Another issue that regained IPTC members' attention was the sales tax concept. Due to statements made in Missoula on April 9 by Governor Racicot in support of a statewide, general retail sales tax and support of further reduction or elimination of property taxes on business equipment, IPTC members again discussed, briefly, sales taxation. Officials from the Department of Revenue did not provide any additional details on the Governor's perspectives regarding a sales tax or business equipment taxation.

Committee to Move to the Northwest...Looking ahead, the IPTC will continue its investigation of options for reforming the property tax system, first in Whitefish on Thursday, May at an all-day (9 a.m.-4:30 p.m.) work session and an evening (7 p.m.) public hearing and then on Friday, May 15 in Kalispell at The Outlaw Inn (9 a.m. to 3 p.m.). At the work session in Whitefish, the IPTC members will focus on the concepts of homestead exemption and "cut and cap" property tax limitations. Some attention may again be focused on the acquisition value alternative as well.

Future meeting dates of the IPTC appear in the calendar at the end of this issue of ***THE INTERIM*** newsletter. The IPTC members are eager to hear anyone's solutions!

Questions regarding the IPTC may be directed to Dave Bohyer, Legislative Services Division, 406/444-3064 or by e-mail to <dbohyer@mt.gov>.

SUBCOMMITTEE ON WELFARE AND CHILD SUPPORT ENFORCEMENT PROGRAMS

Subcommittee Seeks Public Input...The Subcommittee on Welfare and Child Support Enforcement Programs held two public hearings on Thursday, April 21 in order to seek public comment on the options prepared by the Department of Public Health and Human Services. The options address how the Department would operate a public assistance program and a child support enforcement program without federal funds. The first public hearing was held in Room 325 of the State Capitol from 8 a.m. to 12 p.m. The second public hearing was a METNET video conference from 4 p.m. to 6 p.m. The METNET conference was held in Helena, Billings, Bozeman, Butte, Dillon, Glasgow, Great Falls, Havre, Kalispell, Miles City, Missoula, and Sidney.

The witnesses who testified at both hearings overwhelmingly rejected the proposed options. In addition, the witnesses opposed any proposal to reject federal funds for welfare and child support enforcement programs.

Subcommittee Holds Final Meeting...The Subcommittee met for the final time on Wednesday, April 22. The Subcommittee met with representatives from the offices of Senator Max Baucus and Senator Conrad Burns to discuss a proposal from both senators to safeguard the information in the new hire registry for child support enforcement. The Senators have agreed to sponsor legislation that would put a 2-year limitation on the retention of the new hire data for parents who are delinquent in their child support and a 1-year limitation for parents who are not delinquent. The legislation would also impose a fine of $1,000 for the unauthorized access to, disclosure of, or use of information in the new hire registry.

Mary Ann Wellbank of the Child Support Enforcement Division reported to the Subcommittee that the exemption from the use of Social Security numbers on death certificates had been granted, but the exemption for Social Security numbers on applications for certain licenses and in records pertaining to divorce decrees, support orders, or paternity determinations was denied. The Department of Public Health and Human Services has applied for the exemption from automated access to financial records. However, the Department does not believe it has a convincing enough argument for the federal Department of Health and Human Services to grant the exemption.

Ms. Wellbank also presented to the Subcommittee a draft of the legislation that the Division will request in the 1999 legislative session. The bill draft removes the termination dates from Chapter 552, Laws of 1997 (SB 374) and implements the provisions requiring Social Security numbers on applications for all drivers' licenses and on hunting licenses. The Subcommittee debated the merits of combining the revisions to SB 374 with the new federal requirements regarding the expanded use of Social Security numbers. Some members felt that the two issues should be dealt with in

separate bills so that legislators would understand that there are old and new provisions. Other members believed that because both the revisions and the new requirements needed to be passed and would generate the same debate, it would be easier to deal with them all at once in one bill. The Subcommittee came to no conclusion on the issue.

Subcommittee Makes Recommendation...Following a review of the testimony from the public hearings, the Subcommittee discussed recommendations and the final report to the Legislature. The Subcommittee voted to support the removal of the termination dates from Chapter 552 (SB 374). However, the Subcommittee tabled a motion to support the new requirements.

Subcommittee Discusses Final Report...After some discussion, the Subcommittee directed staff to prepare a draft of the final report to be circulated among the members for comments. The final report should be a simple, straightforward analysis of the Subcommittee's work. There should be a clear understanding that the options presented to the Subcommittee are a true picture of what will happen if the Legislature chooses not to pass the revisions to SB 374. The Subcommittee also stated that it is very important that the final document reflect the amount of time that the Subcommittee spent in soliciting public comments on the options and the amount and nature of the public comments. The Subcommittee asked staff if a draft of the final report could be ready for review by the end of May. If the Subcommittee's comments are extensive enough to warrant another meeting, Sen. Swysgood will call a meeting. Otherwise, final approval will be sought through a mail survey.

Subcommittee Grateful for Participation...Speaking on behalf of the Subcommittee, Sen. Swysgood thanked the Department, particularly Hank Hudson and Mary Ann Wellbank and their staffs, for all of the work they did for the Subcommittee. He also thanked the members of the public who attended and participated in the meetings. He felt that the Subcommittee had accomplished what it set out to do, and the members should feel good about their work.

LEGISLATIVE SERVICES DIVISION

Reports Available...The following reports are currently available from the Legislative Services Division. To obtain a copy, please contact the LSD Library at 444-3064 or by e-mail at <efurbush@mt.gov>.

"Legal Issues Surrounding Changes from Defined Benefit to Modified Defined Benefit with a Defined Contribution Component Retirement Plan"

"Legislative Oversight on Correctional Data: An Overview of ACIS and a Request for a Progress Report"

Ballot Measures Received...The following ballot measures have been received and reviewed by the Legal Office of the Legislative Services Division:

- Remove hunting license set aside for outfitter clients
- Eminent domain to take MPC water rights related to dams
- Repeal electric deregulation
- Constitutionally prohibit cyanide mining processes
- Statutorily prohibit cyanide mining processes
- Term limits declaration for congressional candidates

Pursuant to 13-27-202(2), MCA, copies of all correspondence relating to the ballot measures are available through the Secretary of State.

COMMITTEE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS

Committee Looks at Modifying Current System...At its March 6 meeting, the Committee on Public Employee Retirement Systems (CPERS) voted to further consider modifying the current Public Employee Retirement System (PERS) by offering to new employees a choice between either a 100% defined contribution (DC) retirement plan or the current PERS with some added features. The CPERS also decided to explore to what extent current members could be given the choice of transferring into the new plan or staying with the current PERS with no changes.

The new plan to be explored is called the "Retirement Option Plan". The features to be added to the current PERS would include, among other things, a provision to allow members to make pre-tax contributions to a health insurance account that they could later draw on to help fund health benefits after retirement. Another feature being considered as an addition to the current PERS would be an option to rollover unused sick leave into the health care premium account. The Retirement Option Plan, which was one of three options presented by the CPERS benefit design consultants from Actuarial Sciences Associates, Inc. (ASA), is more fully described in the "ASA Report #1", which is accessible on the CPERS Internet homepage at www.state.mt.us/leg/pers_main.htm.

CPERS to Meet...The next step in the process is for ASA to do a comprehensive fiscal analysis of the Retirement Option Plan. The consultants will present their fiscal analysis to CPERS during its meeting on May 22. For further information, please contact Sheri Heffelfinger, Legislative Services Division, at 444-3064 or by e-mail at <sheffelfinger@mt.gov>.

ENVIRONMENTAL QUALITY COUNCIL

EQC to Meet in Great Falls...The Environmental Quality Council (EQC) will meet

on Friday, May 8 in the educational facility at the Cascade County Regional Correctional Facility. The meeting will begin at 9 a.m. Agenda items include:

- Subcommittee reports - Water Policy and Growth;
- underground storage tank removal deadlines;
- voluntary Superfund clean-up program;
- Blackfoot River landslide;
- bull trout management;
- environmental self-audit implementation; and
- Fish, Wildlife, and Parks wildlife programmatic environmental impact statement update.

Montana Growth Issues...At its March 12 work session, the Growth Subcommittee reviewed information that has been presented to date. Workplan topics were discussed and developed. A draft workplan has been prepared for review at the next meeting of the EQC Growth Subcommittee that is scheduled for Thursday, May 7, from 10 a.m. to 3 p.m. in Room 108 of the State Capitol. The proposed goal of the Subcommittee's effort is to change the discussion of growth from one of subdivision review to one of planning for growth; to try to provide incentives for the adoption and implementation of comprehensive planning. The May meeting will include panel discussions on growth related data needs and availability and on a legislative request to review the subject of government lots and the definition of tracts of record.

For agendas or further information, contact Larry Mitchell 444-1352, or e-mail <lamitchell@mt.gov>.

EQC Waste Tire Study...Senate Bill 332 requires that the EQC conduct a waste tire management study and present recommendations to the next Legislature. A Waste Tire Study working group of 25-30 citizens has met twice to present and discuss issues involved in the management of waste tires in Montana and elsewhere. A draft report will be prepared summarizing the problems and potential solutions identified by the group. EQC staff will be developing a draft list of recommendations for review by the Waste Tire Study working group at its next meeting in late June. Final recommendations will be presented for consideration by the EQC.

For further information, contact Larry Mitchell at 444-1352 or e-mail <lamitchell@mt.gov>.

Best Management Practices...At its March 13 meeting, the EQC continued its inquiry into innovations in pollution control with a panel discussion on voluntary BMPs (Best Management Practices) as they are applied to non-point source water pollution in Montana. Six panelists addressed the availability and effectiveness of BMPs for silviculture, agriculture, resource extraction/mining, hydromodification (e.g. streambank alterations), land disposal, and construction. After a presentation on each type of BMP, persons representing a variety of interest groups provided their perspectives on how the application and effectiveness of voluntary BMPs in Montana can be improved, and whether they thought there are components of current regulatory programs that could be replaced with BMPs.

Water Policy...The EQC co-sponsored an interagency coordination meeting, held on March 4 in Helena. Other co-sponsors included the Watershed Coordinating Council, Montana's Department of Environmental Quality (DEQ), and the Statewide TMDL Advisory Group. The purpose was to bring together program staff from various state, local, and federal agencies to discuss how water-related projects can be better coordinated. This is especially important, considering recent developments related to HB 546 (the "TMDL" legislation) and fish recovery efforts; both programs envision broad, voluntary, participation from local watershed residents.

At its May meeting, the EQC will continue to pursue its water-related statutory requirements through the review of water-related research programs in Montana (focusing on those of the Montana University System Water Center, and Montana Tech).

The Council's Water Policy Subcommittee will meet the afternoon of May 7 in Great Falls. They will discuss further their progress on the Council's water-related statutory requirements and provide advice to the Montana Department of Transportation on a legislative proposal. The remainder of the meeting will focus on the Subcommittee's highest priority--oversight of DEQ's implementation of HB 546 (the "TMDL" bill). DEQ staff will present to the Subcommittee their "schedule for completion of TMDLs" that was required by the bill to be complete by May 5, 1998 (one year from its enactment). The schedule assumes the need to complete approximately 800 TMDLs (water quality restoration strategies) in 10 years from the date of enactment. DEQ staff will also discuss their preliminary decision model for determining what level of water quality data will be considered "sufficient" to either add or remove a stream or lake from the "threatened or impaired waters" list. Where they place the data "bar" will affect how many streams will automatically come off the list (because they lack the required level of data), as well as what investments in data collection would be necessary to add a water to the list. The Subcommittee will complete its May meeting with a work session to prepare to package the results of its deliberations for the full Council and Legislature.

For more information, contact Kathleen Williams, EQC staff, at 444-3742.

Next EQC Meeting....The next EQC meeting is scheduled for June 26 in Dillon.

For further information about the May or June meeting, please contact the Legislative Environmental Policy Office at 444-3742 or by e-mail at <teverts@mt.gov>.

ADMINISTRATIVE CODE COMMITTEE

ACC Meets in March...The Administrative Code Committee met on March 20 and considered 3 issues. The Committee considered the public notice and participation requirements for agency action in the context of an application for an air quality permit. The Committee requested the drafting of a bill that would amend the public notice requirements for implementation of public participation in areas of significant public interest.

ACC Admonishes DEQ...The Committee wrote to the Department of Environmental Quality admonishing the DEQ for its nonparticipation in the meeting and for its lack of interest in an issue that involved the citizens of Montana. The Committee letter indicated the belief that it was the intent of the Legislature and the Constitution to provide public hearings in all areas of significant interest to the public and to have parallel notice requirements in the administrative code for the purpose of public hearings. The letter directed DEQ to provide parallel rights to public hearing throughout its rules.

ACC Makes Recommendations to Board of Outfitters...The Committee reviewed the situation where the Board of Outfitters had failed to adopt a rule defining "undue conflict" in areas of net client hunter use (NCHU) expansion, even though statute directed the Board to adopt a rule. The Committee recommended that the Board:

(1) reopen and promulgate rules which define "undue conflict" and develop standards for deciding the issue of undue conflict;
(2) continue to work with representative groups of interested persons and organizations to propose the standards and engage in public comment;
(3) under the guidelines set in Wallace v. Department of Fish, Wildlife, and Parks, defer any action on additional requests for NCHU expansion, within its ability to do so, until standards for review of undue conflict have been adopted; and
(4) complete the revision of rules with all deliberate speed.

ACC Reviews DOC Rules...The Committee also reviewed proposed Department of Correction rules governing the siting of prerelease centers. The Committee had several concerns with the rules primarily in the context of what constitutes an "impacted community". The Department agreed with all concerns expressed by the Committee and agreed to revise the rules to conform to Committee comments.

TRANSPORTATION FUNDING STUDY COMMITTEE

Transportation Funding Study Committee Meets in May...The Transportation Funding Study Committee (HB 610) met on Friday, May 1 in Room 413 of the Capitol Building at 8 a.m. This was planned to be the last meeting in which the Committee receives information needed to formulate its recommendations. The Committee has an August 1, 1998, deadline to conclude its work and report its findings and conclusions to the Legislative Finance Committee and the 56th Legislature. The Committee heard reports on the following topics:

- the Governor's plan for addressing funding shifts;
- Transportation Commission concerns;
- the impacts on the Long-Range Building Program (LRBP) if coal tax is redirected to Highway Special Revenue Account (HSRA);
- status of federal transportation funding legislation;
- response by the Department of Transportation to questions on needs assessments and problems with functions that are currently privatized in the

Department;

- areas in the Department of Justice that are funded by gas tax and that are outside the state transportation safety laws;
- results of a study by the Department of Fish, Wildlife and Parks on state park fees and results of a survey of neighboring states' practices for state parks, snowmobiles, motor boats, and off-highway vehicle programs; and
- revenues from transportation-related fees, fines, penalties, and forfeitures that are not being deposited in the HSRA.

A more complete summary of the meeting will be reported in the June edition of ***THE INTERIM***. Please contact Greg DeWitt of the Legislative Fiscal Division (444-2986) for further information about the Committee.

POSTSECONDARY EDUCATION POLICY AND BUDGET COMMITTEE

PEPB Committee to Meet...The Postsecondary Education Policy and Budget Committee (PEPB) will meet at 9 a.m. on May 18 in the Capitol in Room 104. Agenda items include:

(1) a proposal to merge two of the community colleges with the Montana University System;
(2) consideration of a bill draft to eliminate the statutory language authorizing National Guard fee waivers;
(3) "seamless education" background information and current K-12 and postsecondary education efforts to improve the transition from high school to college; and
(4) additional review of student financial aid issues.

Please contact Sandy Whitney of the Legislative Fiscal Division (444-2986) for further information about the Committee.

LEGISLATIVE FINANCE COMMITTEE

Committee to Meet in June....The Legislative Finance Committee will meet on June 18 and 19 in Room 104 of the State Capitol. The meeting will begin at 1:00 p.m. on June 18. Tentative agenda items include Medicaid estimates, Mental Health Managed Care update, supplemental requests for fiscal 1998, State Fund OFLT projected elimination date, and appropriation control.

Please Contact Clayton Schenck, Legislative Fiscal Analyst (444-2986), for further information about the Committee.

SUBCOMMITTEE ON DEDICATED REVENUES AND STATUTORY APPROPRIATIONS

SB 378 Subcommittee to Meet...The Subcommittee on Dedicated Revenues and Statutory Appropriations (SB 378) of the Legislative Finance Committee (LFC) has scheduled its next meeting for June 17 at 8 a.m. in Room 108 of the State Capitol. The Subcommittee will also meet the morning of June 18 preceding the LFC meeting. The Subcommittee will continue its review of statutory appropriations to determine if they meet statutory guidelines and legislative priorities or if they could be eliminated and replaced with temporary appropriations. If time permits, the Subcommittee will also begin its review of dedicated revenue provisions.

The Subcommittee will begin its meeting with a discussion of the possibility of consolidating statutory appropriations that distribute funds to various local entities. To aid in this discussion, the Subcommittee has invited participation from the Montana Association of Counties, the Montana League of Cities and Towns, the Montana School Boards Association, and the Department of Commerce Local Government Assistance Division.

Questions about the Subcommittee may be addressed to Roger Lloyd and Bob Tallerico of the Legislative Fiscal Division (444-2986).

REVENUE OVERSIGHT COMMITTEE

Committee Meets April 2 and 3...The Revenue Oversight Committee (Committee) met April 2 and 3. The Committee attended to general matters on April 2 and devoted April 3 to a discussion of utility taxation. The Revenue Estimating Subcommittee also met April 2.

Committee Delves Deeper into Electric & Gas Utility Taxation...The Committee spent most of April 3 forging ahead with the taxation study of utilities. Senate Bill No. 390 and Senate Bill No. 396 directed the Revenue Oversight to Committee to examine the taxation of electric and natural gas utilities in a competitive environment. A major part of the study has looked at the property tax implications of competition for all centrally assessed property as well as for rural electric cooperatives and rural telephone cooperatives. At the January 30 Revenue Oversight Committee meeting, Dennis Burr, Montana Taxpayers' Association, presented a proposal to revise the taxation of class nine property (15-6-141, MCA). Class nine property (electric and natural gas utilities, telecommunications, and oil and gas pipelines) is taxed for property tax purposes at 12% of market value. The gist of the proposal would be to reduce the tax rate on class nine property from 12% to 6% and to assess new taxes to make up for the loss in property tax revenue. The new taxes would include a 5% excise tax on final consumers of electricity, natural gas, and telecommunications services and an as yet unspecified replacement tax (perhaps a gross receipts tax) on oil and gas pipelines. In addition, the proposal would increase the electric energy

producers' license tax (15-51-101, MCA) from $0.0002 to $0.0008 per kilowatt hour.

Committee staff presented an analysis of the property tax impact of reducing the class nine property tax rate to 6%. The analysis did not include the direct tax impact associated with the sale of the Montana Power Company (MPC) generating assets, nor did it include the less obvious tax impact to local governments of the change in the unit value of other Montana Power operating property as a result of the sale. Rural electric cooperatives and rural telephone cooperatives were not included in the analysis because that property would not be directly affected by the proposal.

The analysis showed the reduction in the taxable value of centrally assessed property in each county as a result of reducing the property tax rate. The reduction in the taxable value of centrally assessed property includes the secondary effect of reducing the property tax rate applied to class twelve railroads and airlines (15-6-145, MCA) from 6.31% (tax year 1997) to 4.56%. Federal law prohibits the discriminatory taxation of railroad and airline property. The tax rate applied to class twelve property is the average tax rate applied to other commercial and industrial property.

The average statewide reduction in taxable value would be 13.6%. In 20 counties the reduction in taxable value would be greater than the statewide average, and in many instances much greater. The greatest impact would be in Rosebud County (-41.7%), followed by, in order, Wheatland County(-32.6%), Sanders County (-32.2%), Golden Valley County (-28.3%), and Roosevelt County (-26.3%). In only six counties is the reduction in taxable value less than 5%.

The overall reduction in property taxes would amount to $81.1 million. Of that amount, $44.7 million is attributable to electric and natural gas utilities, $16.7 million to telecommunications, $12.8 million to pipelines, and $6.9 to railroads and airlines. State property taxes (95 mills for K-12 education and the 6-mill university levy) would fall by $29.3 million, while the loss to local governments would be $51.8 million. Rosebud County accounts for a little over a quarter of the reduction in statewide levies.

The analysis is muddled by the sale of MPC generating assets. The Department of Revenue (Department) has estimated that the sale of the assets would result in a $7.9 million loss in property tax revenue. However, the actual loss, if any, will be related to the sales price and to the taxable status of the successful bidder or bidders. Other owners of generating assets in Montana may also elect to sell their Montana generating assets. Another complication associated with the sale of generating assets is the impact on the unit value of remaining operating property owned by Montana Power and the allocation of that value to the counties.

<u>Interstate Tax Comparisons</u>...Gordy Higgins, Legislative Services Division, presented a comparison of the tax burdens of investor owned utilities in surrounding states with Montana Power. Taxes paid by MPC as a percentage of total operating revenue are higher than any of the comparison utilities. Higgins pointed out that a burdensome tax structure may inhibit traditional energy providers from maintaining a profitable share of the market. Under competition, it is doubtful that existing procedures that depend on utilities to collect taxes from consumers will continue to work effectively. As customers recognize that electric prices are made up, in part, of state and local taxes, it is possible that many of these customers will switch to

providers that are not burdened by high state taxes in order to reduce their overall electric power bills. Further, if the method of taxing utilities does not evolve simultaneously with the changing energy market, some utilities may lose customers and consequently the ability to pass taxes on to ratepayers, thus putting the utilities at a competitive disadvantage.

Under traditional regulation, utilities pay a variety of taxes that are generally passed on to consumers in the cost of service rate base. The proportion of taxes to total utility operating revenue shown in the table below indicates that some states treat their utilities better than others.

"Comparative Utility Tax Burdens: Western Regional Electric Utilities-1996
Taxes as a proportion of Total Electric Utility Operating Revenue"

Arizona:	Tucson Electric	8.4%
	AZ Public Service	9.4%
Colorado:	CO Public Service	4.7%
Idaho:	Idaho Power	4.2%
Kansas:	KS Gas & Electric	9.2%
Montana:	Montana Power	10.6%
New Mexico:	NM Public Service	5.2%
Nevada:	Nevada Power	2.4%
	Sierra Pacific Power	3.1%
North Dakota:	MDU Resources	5.7%
Oregon:	Pacificorp	4.1%
	Portland General	6.6%
South Dakota:	Black Hills Corp.	4.5%
Washington:	Puget Sound Power	9.7%
	WA Water Power	6.4%

Source: Energy Information Administration
Financial Statistics of Major U.S. Investor-Owned Utilities-1996

Higgins said that the challenge for states that have opted for restructuring is to develop a tax structure that satisfies the criteria of economic efficiency and equity, is reasonably consistent, and minimizes the impact on taxing jurisdictions. Tax policy related to the emerging competitive market should not adversely affect the economic

decisions of electric suppliers or consumers and should strive to place all suppliers, if not on a level surface, at least on the same field.

Department of Revenue Outlines Restructuring Tax Issues...Staff of the Department of Revenue, including Mary Bryson, Director; Gene Walborn, Property Tax Division; Steve Austin, Corporation Tax Division; and Pat Dringman, Legal Affairs, presented a panel discussion of taxation issues related to restructuring. In addition to restructuring of the electric and natural gas utilities, the 1997 Legislature revised the structure of the telecommunications industry to conform with the federal Telecommunications Act of 1996. The panel discussed several revenue and tax policy issues related to a new competitive environment for all three industries.

Nexus may be one of the more difficult issue that states must deal with under restructuring and deregulation of the traditionally regulated utilities and the new technologies that emerge. The U.S. Constitution and federal law generally limit a state's ability to tax multistate corporations. A state may not tax a business unless there is a minimum connection, or nexus, between the taxing state and the business. Nexus is usually determined by physical presence. However, economic presence as evidenced by intangible property in the state, such as a trade name or accounts receivable, may establish nexus for the purposes of taxation. On the other hand, federal law (P.L. 86-272) prohibits the taxation of a business whose only connection to the state is the solicitation and sale of tangible personal property and the order is supplied by an out-of-state company. The significance of the nexus issue is whether Montana will be able to tax out-of-state suppliers of electricity, natural gas, and telecommunication services and whether the state may lose revenue from in-state providers who have established nexus in other states.

Another significant effect of restructuring relates to property tax issues. Of immediate concern is the proposed sale of Montana Power's generating assets. The conventional view is that the new owner of the MPC generating assets will be taxed at 3.186% for real property and at 6% for personal property. Unless the assets sell for a lot more than book value, the loss in total property tax revenue may be about $8 million. In addition, federal law provides for open access to all privately owned transmission lines. As such, users of the Bonneville Power Administration transmission lines who pay beneficial use taxes for the use of those lines may gain access to other transmission routes. The Department also noted that the sale and potential reclassification of MPC natural gas utility property may reduce the valuation of existing property.

Although there is no specific legislative mandate to examine the property tax treatment of the telecommunications industry, the Committee has considered the issue, at least tangentially, in its analysis of the taxation of electric and natural gas utilities. The Department pointed out that while traditional telephone companies are centrally assessed, many of their competitors, such as interexchange resellers and wireless telecommunication providers, are locally assessed, despite the fact that their operations often cross county lines. The Department avers that it is necessary to address the issue of whether wireless companies should be treated differently from wire companies.

Other Utility Tax Issues Before the Committee.. Lee Heiman, staff attorney, presented an analysis of the classification of property related to the sale of the Montana Power's ownership interest in the Colstrip electric generating plants. The issue is whether different classes of owners of the same property (i.e., the Colstrip plants) may be taxed at different rates. If the differences in tax rates was legally challenged, the court would have to determine whether there is a rational basis for the distinction. Committee staff also presented several options to revise the taxation of utilities. Those options and others will be discussed by the Committee at the next meeting.

April 2 Meeting a Potpourri of Topics...Committee staff presented a summary of Senate Bill No. 57, a bill that revised the taxation of passenger vehicles and heavy trucks. Passenger vehicles (cars, light trucks, vans, and sport utility vehicles) are now taxed at 2% (or up to 2.5% if a county imposes a local option tax) of the depreciated value of the vehicle's manufacturer's suggested retail price. The depreciation schedules for passenger vehicles are based on the age and type of vehicle. Heavy trucks (all vehicles having a rated capacity of more than 1 ton) now pay a fee in lieu of tax based on age and weight of the vehicle. Several Committee members had received complaints from taxpayers, particularly owners of light trucks and SUVs, that the new method resulted in a higher tax on their vehicle. The Committee will review data by type of vehicle to determine whether an adjustment to the depreciation schedules is needed.

The new method of taxing motor vehicles was designed to be revenue neutral. Dean Roberts, Motor Vehicle Division, presented a summary of tax collections for fleet registration. So far the amount of tax collected from fleet passenger vehicles this year is comparable to last year, but the amount collected for fleet heavy trucks is considerably less. The Committee will monitor collections for the remainder of the interim. Roberts also reported that the administration of the new method is working very well for the taxpayer, county treasurers, and the Motor Vehicle Division. Senate Bill No. 57 also directed the Legislative Audit Committee to study the taxation of motor vehicles, with particular emphasis on a recommendation for a flat fee on all vehicles as well as multiyear registration. Look for a proposal from the Audit Committee in the next several months.

Department of Revenue Restructuring, Nee Project MET ...Mary Bryson, Director, Department of Revenue, presented information on the reorganization of the Department of Revenue. Through a visioning process, the Department has initiated an internal restructuring along business processes rather than along the more mundane tax types (e.g., income taxes, natural resource taxes, property taxes). The new processes include, among others, customer (taxpayer) intake; compliance, valuation, and resolution; document and information processing; accounts receivable and collections as well as tax policy and research and legal affairs. An aside: the Department has appointed, under the provisions of 2-15-122, MCA, a stakeholder advisory council to advise the Department in its "business process reengineering" efforts. The membership of the advisory council includes legislators (none from the Revenue Oversight Committee), other state agency directors, taxpayer groups, local

government representatives, and other organizations that have frequent contact with the Department.

Cabaret Licensing...Senate Bill No. 257 allows restaurants to obtain beer and wine licenses under certain conditions. Jeff Miller, Administrator, Department of Revenue, presented a status report on the issuance of the new licenses. Fifty-four license applications are in some stage of review. Committee members were concerned that many applicants or potential applicants have become frustrated with the process. Miller told the Committee that the application process requires some time for completion but that the review is generally completed within a 90 day period.

Miscellaneous...Terry Johnson, Legislative Fiscal Division, presented a report on state general fund collections to date, and Brenda Brenner, Department of Revenue, summarized individual income tax statistics from 1996 tax returns. The Department reported on potential legal challenges to the phased-in reductions of property valuations under SB 195, reviewed proposed changes to liquor licensing rules, discussed the legislative audit regarding the valuation of agricultural land, and reviewed on-going litigation.

Revenue Estimating Subcommittee Meets in March and April . .The Revenue Estimating Subcommittee met March 4 and April 2. At the March 4 meeting, the Subcommittee reviewed revenue estimating profiles for natural resource taxes and began a discussion on the appropriate format of the Legislature's revenue estimating resolution. On April 2, the Subcommittee reviewed revenue profiles for interest and income earnings, property taxes, and nonlevy revenue. Legislative and executive branch staff informed the Subcommittee that there is general agreement on the methods used for the individual income tax model and the corporation license tax model.

Next Meetings in May...The Revenue Estimating Subcommittee will meet May 28 and the full Committee will meet May 29, in Room 104 of the State Capitol. The Subcommittee will finish its review of the revenue estimating profiles and will consider suggestions to revise the revenue estimating resolution. The focus of the full Committee will be on utility taxation. Jim Kane from Arthur Anderson, LLC, will offer insights into revising the tax structure for electric utilities. Committee staff will present preliminary estimates of potential revenue from excise taxes or commodity taxes on electric and natural gas utilities and telecommunication services to replace revenue from a reduction in the property tax rate applied to class nine property. The Committee will discuss options on how or whether to revise the taxation of these industries.

OVERSIGHT COMMITTEE ON CHILDREN AND FAMILIES

Committee Discusses Child Abuse Prevention...April was National Child Abuse Prevention Month, which seemed particularly necessary in light of the recent child deaths and injuries at the hands of "grown-ups" that have made the news in Montana this spring, not to mention the countless other incidents that go unreported. The Joint Oversight Committee on Children and Families met on April 17 and engaged in a lengthy discussion about child abuse, child abuse prevention, and the Department of Public Health and Human Services' (DPHHS) child protective programs.

At a previous meeting, the Montana Council for Families (Council) presented the Committee with background information on child abuse and the efforts that are underway to eradicate child abuse from Montana's landscape. The Council requested the Committee's support for funneling federal block grant dollars into a couple programs aimed at promoting responsible parenting and at helping families who are on the verge of crises.

With the assistance of the Council, the Committee determined that the best way to encourage applying federal dollars to child abuse prevention projects would be to express its support for the ongoing prevention efforts and to let local grant advisory groups and DPHHS know that there is legislative backing for the concept of these community-based child abuse prevention programs. The Committee sent two letters to Director Ekanger, the local advisory groups, and the legislative chairs of the Finance and Claims and Appropriations Committees expressing its support for and belief in child abuse prevention and parent support at the community level. One of the Committee's letters follows this Committee update.

As a follow-up, the Committee will devote a considerable amount of time at its next meeting to learning more about DPHHS' child protective programs and working with Director Ekanger and Department staff to explore ways the system could be improved.

Committee to Meet in June...Committee members decided on June 22 for its next meeting at which time, it will receive updates on the Children's Health Insurance Program state plan and the Interagency Coordinating Council's modified unified prevention budget prototype. Members will also be refreshed on how state statutes would need to be altered to incorporate the Uniform Child Custody Jurisdiction and Enforcement Act that has been adopted by the National Conference of Commissioners on Uniform State Laws (of which Attorney General Mazurek and Supreme Court Justice Nelson are members), and endorsed by the American Bar Association. The Committee will also be presented with bill drafts it has offered to request for DPHHS that will address extended licensing for child care providers and the issuance of a single license for different child care facility types.

Notices will be sent to all interested persons once the room number, time, and agenda items are finalized for the June 22 meeting. If you have any questions, contact Leanne Kurtz at <lekurtz@mt.gov> or by phone at 444-3064.

COMMITTEE ON STATE MANAGEMENT SYSTEMS

Importance of Communications Equipment...Imagine you are deep in the woods, searching for that elusive 7-point bull elk who has eluded you for the last five seasons. You spy him through some heavy timber. He is minding his harem some 40 feet below you. All you have top do is quietly make it down this small cliff with plenty of hand and foot holds. Halfway to your quarry, who remains unaware of your presence, you startle a pair of jays that had been huddling in one of the cracks of the cliff. They squawk and flutter in your face and you react by waving your arms at them to get them to shut up, still thinking that the big bull is going to get away. As you are bouncing down the cliff, scattering gear and cursing all the way, all you can think is that once again, you have been skunked. As you come to a stop at the foot of the cliff in a mangled heap, you realize that not just your pride, but your rifle and your leg have been badly injured. For several hours, you lie there, contemplating the meaning of life and perhaps dreaming up some bill drafts to request next session.

Meanwhile, your partners have alerted the authorities that you are missing. They are comfortably sitting in a tavern somewhere speculating on your condition, awaiting word. Search and Rescue crews scour the area, but find they are unable to communicate with each other; their radios have failed. A lone crew member finds you. You are rescued. But that crew member can't radio for help, can't call a helicopter to haul you out, and can't alert your friends and family that you are battered but alive, because the radio has become a useless chunk of metal. You had no way of knowing, but a Fish, Wildlife, and Parks warden was only a few miles away with a warm vehicle and a Snickers bar. You end up hopping your way out of the woods on one foot. It is a painful, arduous trek and it could have been a lot worse.

Committee Discusses Public Safety Communications...It is an unenviable and completely fabricated predicament. But the scene described above and much larger disasters would be conceivable if the state's public safety communications systems and facilities are allowed to degrade. Consider how much we all rely on the ability of the Highway Patrol, Search and Rescue, firefighters, ambulances, and other emergency response teams to communicate among themselves and with others. At its March 10 meeting, the Committee on State Management Systems heard about the inadequacies of the current system, some system design recommendations and a cost estimate for designing the upgrade of the public safety communications infrastructure. The Department of Administration and its Information Services Division (ISD) plan to develop a package to submit to the 1999 Legislature as one of the planks in its public safety communications upgrade platform.

Montana's aging public safety communications systems are plagued by inadequate maintenance of radio and other facilities, increasing channel congestion, growing interference, a growing demand for inter-agency response to emergencies, limited functionality, and unnecessary duplication of infrastructure. ISD reports that the changing regulatory environment on the federal level and advances in technology make

this an opportune time to address the state's communications shortcomings.

State, rural and city agencies overlap in their responsibilities to maintain public safety and mitigate potential disasters. The stakeholders in the public safety communications systems include tribal police, the Forest Service, airlines, hospitals, schools, prisons, hazardous material crews, the ATF, FBI, BLM, and a number of other acronyms, not to mention the Joe Public, for whom these systems are absolutely critical.

ISD Coordinating Project...ISD has outlined project phases, hired a consultant to complete a system concept design, and formed a Public Safety Radio Task Force, composed of many of the affected agencies. The task force approved the final system concept design last May and in January, Governor Racicot appointed a Public Safety Communications Council with membership representing state, city, county, and tribal agencies in addition to technical specialists.

All of the final design and implementation activities take place with the oversight of the Public Safety Communications Council. Once that is completed, ISD moves into the implementation phase, expected to take about 10 years. The implementation phase will consist of selecting vendors through the RFP process, creating a permanent governance structure to oversee maintenance of the new systems, and finally, installing new radio infrastructure and communications systems.

ISD estimates a total project design budget of $546,000. This figure anticipates contributions from the state General Fund ($20,000 for FY 98 and FY 99), the state Special Revenue Fund ($51,500 for each fiscal year), the private sector ($136,500 for each fiscal year), and city and county governments ($65,000 for each fiscal year).

Already underway, this project will equip future rescuers involved in future hunting, fishing, hiking, and camping expeditions, not to mention responders to chemical spills, auto accidents, and fires, the necessary communications tools to save lives, mitigate disaster, and locate a warden with a Snickers bar.

To Meet in June...The Committee on State Management Systems plans to meet next on June 3. Among the items discussed will be legislative chamber automation, electronic commerce, and imaging. Contact Leanne Kurtz at <lekurtz@mt.gov> or by dialing 444-3064 for more information.

THE BACK PAGE

Heading into the 55th Legislative Session, Montana's legislators faced the double-edged dilemma of property values on homes and businesses increasing at a statewide average of 43 percent. On the one hand, increased values would potentially result in increased state revenue that could be used to fund corrections programs, health insurance for the indigent, and public schools or to reduce other taxes. On the other hand, the increased property values portended potential increases in property taxes paid by Montana's homeowners, renters, business people, farmers and ranchers, and timber growers.

Thus, Senate Bill 195 was enacted that virtually froze property values for the purpose of taxation and created the Interim Property Tax Committee to study the state's property tax system. When completed with its work, the Committee is directed to present a "menu of alternatives" for reforming the property tax system.

This month's "**The Back Page**" article looks at the activities and progress of the Interim Property Tax Committee, particularly the options under consideration by the Committee.

REFORMING MONTANA'S PROPERTY TAX SYSTEM

by David Bohyer, Research Director
Legislative Services Division

INTRODUCTION

For most Montanans, the principal asset in which families invest is their home. As with all investments, growth in the value of assets is a major goal. That goal is being achieved by most Montana homeowners as market values of homes across the state increased an average of 43 percent between 1993 and 1997, an annual compounded rate of about 12.6%. That appreciation in the value of homes as an asset is welcome news for Montana homeowners, except when that appreciation and the consequent value of the asset is subject to taxation.

Faced with potential double-digit percentage increases in property taxes for their property-tax-paying constituents, members of the 55th Montana Legislature wrestled with several dilemmas brought about by the appreciating property values. After deliberate if painstaking consideration of policy alternatives, legislators endorsed Senate Bill No. 195 (SB 195, Ch. 463, L. 1995). Under SB 195, the new values for property tax purposes of homes, businesses, farms, ranches, and timber land were to be phased in at a flat percentage of the total change in value over a fixed period of time. The "phase-in" percentage settied upon was 2% annually and the time period for the phasing was set at 50 years. Additionally, the statutory tax rate applicable to homes, businesses, and agricultural land (including grazing) is to be reduced by .022%

each year for 50 years, resulting in a gradual decline in the tax rate from 3.86% of market value (in 1996) to 2.78% of market value (in 2046).

The legislation also established the Interim Property Tax Committee (Committee), commissioned the group to examine Montana's property tax system, and challenged the members to develop a "menu of alternatives" for reforming the state's property tax system.

COMMITTEE ACTIVITIES

Reforming the state's property tax system loomed as a daunting task and the Committee, in July 1997, approached the assignment with a high sense of responsibility, if not also with a little trepidation. Over the ensuing 12 months, the Committee planned a total of a dozen work sessions and 18 public hearings in communities across the state. In the early stages, Committee members were flooded with information from staff and others on the history of property taxation, interstate tax comparisons, relative tax burdens borne by Montanans, systems employed in other states, and property tax alternatives practiced in other jurisdictions, both in the United States and elsewhere.

Some of the Committee's findings so far include:

Taxpayers desire predictability and stability in property taxes. [Analysis shows that property tax revenue increased at an average annual rate of less than 2.9% from 1972 to 1996.]

Reappraisals cause abrupt, significant changes in property values and tax shifts. [Property reappraisals in 1977 and 1985 were accompanied by legislation that neutralized increased market values by proportionately reducing statutory tax rates. Similarly, SB 195 was enacted in 1997 to off set the effects of the most recent reappraisal of property.]

Tax rate decreases for one class of property shifts the property tax burden to other property. [Assuming revenue neutrality or diminishment, all property that is not subject to the tax rate decrease will bear a proportionate share of the burden formerly borne by the property on which tax rates are reduced.]

School equalization is dependent on statewide mills levied on property. [State revenue for schools, generated by the 95 mills levied statewide, comprises approximately one-half of total state spending on K-12 education.]

Property taxes are perceived to be going up faster than income for many taxpayers. [Consider: Between 1972 and 1996 total property tax revenue increased about 2.9% annually, but: total personal income increased 6.36% annually; per capita income increased 5.2% annually; and CPI inflation increased

at about 4.6% annually.]

Fees for services are increasing under I-105. [With caps on mill levies and taxes imposed by e.g., I-105, municipalities especially are increasingly turning to "fees for services" from everything from lighting districts to street maintenance districts and others.]

Business equipment taxes are perceived to contribute to a poor business environment in Montana. [Montana's statutory tax rates on business equipment have decreased by 50% in the last 3 years and, on certain property, by over 62% since 1990. However, Montana's business equipment tax rates still exceed the rates on business equipment in nearby states.]

Additionally, the Committee has also solicited and entertained comments and testimony from the public, local government elected officials, Department of Revenue staff, school officials, and others. Comments made to the Committee during both work sessions and public hearings have ranged from "the system works pretty well" to "throw out the whole works and start over". From Dillon to Wolf Point, Miles City to Hamilton, nearly all homeowners say that they wish their property taxes were lower. Local government elected officials and school administrators, while sympathetic to the homeowners' viewpoints, nearly all want access to a broader tax/revenue base "to provide the essential services and programs that their citizens expect".

PROGRESS IS GOING, , , WELL?

In a brief presentation to the Revenue Oversight Committee on April 3, 1998, the Interim Property Tax Committee's lead staffer, Dave Bohyer, reported on the activities and accomplishments of the Committee. In those remarks, he stated that he was happy to report that the Committee is looking at options for revising the property tax system that will include:

- significant reductions in property taxes in every jurisdiction in the state;
- significant reductions in the taxes paid by every class of property statewide, including reductions on agricultural and timber lands, industrial property, utilities, business equipment, and residential commercial property;
- significant reductions in the 101 mills levied statewide for K-12 education and the university system;
- significant reductions or the complete elimination of state income taxes;
- substantial reductions in government bureaucracy and administrative costs associated with state and local governments, especially schools;
- immediate and substantial improvements in local government services, including county roads and bridges, city streets, and other public infrastructure;
- immediate and substantial improvements in K-12 education, from smaller class sizes to improved classrooms, equipment, curriculum and buildings;

- state and local spending patterns and budgets that will be unanimously and vigorously supported by every taxpayer in Montana; and, finally,
- assurances that exceed Constitutional guarantees that no tax imposed by the state or any local government will ever increase and that no new tax will ever be imposed.

When the laughing subsided, he also stated that the foregoing list was more an inventory of suggestions made and expectations stated during the work sessions and public hearings than it was a summary of options under consideration by the Committee. But feelings run deep when it comes to taxing a prized possession, particularly a home. And, thus, attention turned to the more realistic alternatives under consideration by the Committee.

FROM HERE TO ALTERNATIVE

There are basically five options being considered by the Committee as of this writing. In short, the options include:

- enacting a sales tax as a replacement for property taxes (primarily for education);
- the full or partial exemption from property taxation of owner-occupied residences;
- the acquisition value method of assessing property for tax purposes;
- imposing property tax limits through statutory mill levy reductions and property tax caps; and
- the status quo alternative, i.e., leave SB 195 in place for the next 50 years or until court action or a citizens' initiative allows for or requires something different.

The sales tax option is generally regarded as the only practical option that could provide dollar-for-dollar replacement of property tax revenue. Recent estimates indicate that a 4% general statewide sales tax could generate between $400 million and $525 million in annual revenue, depending of course on the health of the economy and on whether or not the sales tax base is narrow or broad. While support for the sales tax concept has been fairly broad among attendees of the Committee's hearings, the depth of the support is more debatable, particularly when details of taxable events or distribution of revenue is discussed. Among the Committee members, support ranges from very strong to outright opposition.

The homestead exemption alternative could provide for the total or, more likely, partial exemption from taxation of an owner-occupied residence (homestead). Discussions had during the 1997 legislative session revolved around a direct but flat approach, e.g., exempting the first $50,000 or less of market value of a homestead to a graduated approach, whereby a percentage (e.g., 65%) of a portion of value (e.g., the first $50,000 or less of market value) would be exempt from property taxation. Some public hearing participants show interest in this alternative, but support is difficult to

measure. The Committee members have yet to focus on this alternative so far.

Under the acquisition value option, property could be valued for tax purposes at the value at which the property was acquired by the current owner and, after acquisition, adjusted by the lower of a fixed percentage of value (e.g., 3%) or CPI inflation. Variations of the acquisition value option are in place and operating in both California (Proposition 13) and Florida. Suboptions under consideration by the Committee include acquisition value for all Class 4 property (homes and businesses) or for owner-occupied residences only. Public hearing participants show interest in this alternative as well, but support is difficult to measure. Among the Committee members, attitudes range from very strong support to lukewarm support (maybe).

The property tax limitation alternative could be viewed as a "cap and cut" approach, whereby property tax revenue could be "capped" as of a specific fiscal year (e.g. 1996) and statutory mill levies could be "cut" to off-set increases in taxable value due solely to property reappraisal for tax purposes. As with the acquisition value and homestead exemption options, comments made at public hearings indicate some citizen interest in this alternative as well, but support is difficult to measure. Among the Committee members, interest and attitude are difficult to assess as of now.

The status quo option may be the least desirable option and yet the most likely option. The desirability of this option was alluded to in testimony on SB 195 wherein its champions and supporters recognized it as a temporary but practical solution for the time being. The likelihood of this option continuing into the near future may be a good bet because any alternative to the status quo will have problems of its own. Property taxes are a complicated matter and changes in the system do not affect all taxpayers or governmental jurisdictions uniformly. Thus, an undesirable but well known system may be preferable to an unknown, untried alternative As time marches on, however, valuation and tax bill disparities between similar taxpayers and local government (including schools) financing woes may force change, either through litigation or by other means.

SOLUTIONS ANYONE?

No options have been approved yet by the Committee for inclusion on the "menu of alternatives" and the only option even formally proposed by a Committee member so far is one version of the acquisition value alternative. Diligently, the Committee members continue to work individually and collectively to craft options that may gain the favor of the 56th Legislature and Montana's citizens. Four more work sessions and seven more public hearings will be conducted during the remainder of the interim and the Committee remains eager to hear suggestions for improving the system. Whether by phone, fax, cyberspace, or snail mail, the Committee would like to hear your rendition of a solution to the property tax problem -- whatever that problem is. For convenience, the dates and locations/cities of future Committee meetings are included in the calendar at the end of this issue of ***THE INTERIM***.

INTERIM CALENDAR

UNLESS OTHERWISE SPECIFIED,
ALL ROOM DESIGNATIONS ARE IN THE CAPITOL

MAY

May 1, Correctional Standards and Oversight Committee, Room 104

May 1, Transportation Funding Study Committee, Room 413, 8 a.m.

May 7, EQC Growth Subcommittee, Room 108, 10 a.m.

May 7, EQC Water Policy Subcommittee, Great Falls, Cascade County Regional Correctional Facility (3800 Ulm North Frontage Road), 12:30 p.m.

May 8, Environmental Quality Council, Great Falls, Cascade County Regional Correctional Facility (3800 Ulm North Frontage Road), 9 a.m.

May 14, Interim Property Tax Committee, Whitefish, North Valley Medical Center Community Room (6575 Highway 93 South), 9 a.m.; Public Hearing, 7 p.m.

May 15, Interim Property Tax Committee, Kalispell, The Outlaw Inn, Public Hearing, 9 a.m.

May 15, Legislative Council, Room 104

May 18, Postsecondary Education Policy and Budget Committee, Room 104, 9 a.m.

May 22, Committee on Public Employee Retirement Systems, Room 104

May 28, ROC Revenue Estimating Subcommittee, Room 104, 10 a.m.

May 29, Revenue Oversight Committee, Room 104

JUNE

June 3, Committee on State Management Systems

June 17-18, Subcommittee on Dedicated Revenues and Statutory Appropriations, Room 108, 8 a.m.

June 18, Legislative Finance Committee, Room 104, 1 p.m.

June 19, Legislative Finance Committee, Room 104, 8 a.m.

June 18, Interim Property Tax Committee, Havre, 9 a.m.; Public Hearing, 7 p.m.

June 19, Interim Property Tax Committee, Great Falls, Public Hearing, 10 a.m.

June 22, Oversight Committee on Children and Families

June 26, Environmental Quality Council, Dillon

NOTE: The Interim Property Tax Committee also has the following meetings and public hearings scheduled: August 6, Columbus; August 7, Billings; and September 11, Helena.

370 copies of this public document were published at an estimated cost of 60¢ per copy, for a total cost of $222.00, which includes $162.00 for printing and $60.00 for distribution.

Legislative Services Division
Room 138, State Capitol
P.O. Box 201706
Helena MT 59620-1706